FILE COPY

Supreme Court, U. S.
FILED
OCT 6 1942
CHARLES ELMORE CROPLEY
CLERK

No. 48

In the Supreme Court of the United States

OCTOBER TERM, 1942

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JOHN STUART

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Specification of errors to be urged	7
Summary of argument	8
Argument:	
I. The trust income is taxable to the grantor under Section 166 of the Revenue Act of 1934	10
II. Section 167 also applies	22
III. As a further alternative, the income of the trusts is taxable to the grantor under Section 22 (a) of the Revenue Act of 1934	28
Conclusion	33
Appendix	34

CITATIONS

Cases:

Altmaier v. *Commissioner*, 116 F. (2d) 162, certiorari denied, 312 U. S. 706	19, 27
Botzum v. *Havana National Bank*, 367 Ill. 539	17, 18
Chandler v. *Commissioner*, 119 F. (2d) 623	17
Commissioner v. *Berolzheimer*, 116 F. (2d) 628	29
Commissioner v. *Brown*, 122 F. (2d) 800	29, 30, 33
Commissioner v. *Buck*, 120 F. (2d) 775	29, 30, 33
Commissioner v. *Caspersen*, 119 F. (2d) 94, certiorari denied, 314 U. S. 643	15, 19, 27
Commissioner v. *Warner*, 127 F. (2d) 913	21
Cox v. *Commissioner*, 110 F. (2d) 934, certiorari denied, 311 U. S. 667	29
Dickey v. *Burnet*, 56 F. (2d) 917, certiorari denied, 287 U. S. 606	11
Fawcus Machine Co. v. *United States*, 282 U. S. 375	26
Frank v. *Frank*, 305 Ill. 181	17
Fulham v. *Commissioner*, 110 F. (2d) 916	19
Gilman v. *Bell*, 99 Ill. 144	17, 18

Cases—Continued.

	Page
Harrison v. *Schaffner*, 312 U. S. 579	29
Helvering v. *Clifford*, 309 U. S. 331	9, 19, 28
Helvering v. *Elias*, 122 F. (2d) 171, certiorari denied, 314 U. S. 692	29
Helvering v. *Evans*, 126 F. (2d) 270, pending on petition for certiorari, Nos. 107–108, present Term	15, 27
Helvering v. *Fuller*, 310 U. S. 69	29, 33
Helvering v. *Horst*, 311 U. S. 112	29
Helvering v. *Safe Deposit & Trust Co. of Baltimore*, 316 U. S. 56	18
Helvering v. *R. Douglas Stuart*, No. 49, present Term	7, 20
Hormel v. *Helvering*, 312 U. S. 552	29
Irish v. *Commissioner*, 129 F. (2d) 468	28
Jacobs v. *Commissioner*, 129 F. (2d) 99	29, 30
Jones v. *Jones*, 124 Ill. 254	17
Kaplan v. *Commissioner*, 66 F. (2d) 401	27
Kent v. *Rothensies*, 120 F. (2d) 476, certiorari denied, 314 U. S. 659	27
Loeb v. *Commissioner*, 113 F. (2d) 664, certiorari denied, 311 U. S. 710	15, 19, 27
Magruder v. *Washington, Baltimore & Annapolis Realty Corp.*, 316 U. S. 69	26
Maguire v. *City of Macomb*, 293 Ill. 441	17
Manhattan Co. v. *Commissioner*, 297 U. S. 129	26
McCauley v. *Commissioner*, 44 F. (2d) 919	11
McKnight v. *Commissioner*, 123 F. (2d) 240	29
Morrissey v. *Commissioner*, 296 U. S. 344	26
Morton v. *Commissioner*, 109 F. (2d) 47	15, 22
Northern Trust Co. v. *Porter*, 368 Ill. 256	17
O'Donnell v. *Commissioner*, 64 F. (2d) 634, certiorari denied, 290 U. S. 699	11
People, The v. *Kaiser*, 306 Ill. 313	17
Phipps v. *Helvering*, 124 F. (2d) 288	28
Reinecke v. *Smith*, 289 U. S. 172	17, 22
Rock Island Bank v. *Rhoads*, 353 Ill. 131	17
Rollins v. *Helvering*, 92 F. (2d) 390, certiorari denied, 302 U. S. 763	19, 27
Sanford, Estate of v. *Commissioner*, 308 U. S. 39	33
Taft v. *Commissioner*, 304 U. S. 351	26
United States v. *Dakota-Montana Oil Co.*, 288 U. S. 459	26
United States v. *Field*, 255 U. S. 257	18
Welch v. *Caldwell*, 226 Ill. 488	17
White v. *Higgins*, 116 F. (2d) 312	28, 29
Whiteley v. *Commissioner*, 120 F. (2d) 782, certiorari denied, 314 U. S. 657	29

Statutes: Page

Revenue Act of 1924, c. 234, 43 Stat. 253:
Sec. 219 10
Revenue Act of 1926, c. 27, 44 Stat. 9:
Sec. 219 11
Revenue Act of 1928, c. 852, 45 Stat. 791:
Sec. 166 11
Revenue Act of 1932, c. 209, 47 Stat. 169:
Sec. 166 11
Revenue Act of 1934, c. 277, 48 Stat. 680:
Sec. 22 34
Sec. 166 ..... 8, 10, 34
Sec. 167 ..... 8, 22, 35

Miscellaneous:

Pomeroy's *Equity Jurisprudence* (5th ed.), Vol. 3, sec. 1002 17
S. Rep. No. 665, 72d Cong., 1st Sess., pp. 34-35 (1939-1 Cum. Bull. (Part 2), pp. 496, 520-521) 11, 24
Treasury Regulations 86:
Art. 22 (a)-1 35
Art. 166-1 ..... 14, 15, 22, 36
Art. 166-1, as amended 39
Art. 167-1 44
Art. 167-1, as amended 46
Treasury Regulations 94:
Art. 166-1 22
Art. 167-1 26
Treasury Regulations 101:
Art. 167-1 26
Treasury Regulations 103:
Sec. 19.166-1 22
Sec. 19.167-1 26

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 48

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JOHN STUART

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 27–32) is unreported. The opinion of the Circuit Court of Appeals (R. 38–49) is reported in 124 F. (2d) 772.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered December 19, 1941 (R. 49). The petition for a writ of certiorari was filed March 19, 1942, and was granted April 27, 1942. The jurisdiction of this Court is conferred by section

240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer established three trusts, one for each of his three children, naming himself, his wife and his brother as trustees. The corpus of each trust consisted of shares of stock in a corporation of which the taxpayer was president and his brother was first vice president. The grantor reserved the right to direct the trustees with respect to sales and reinvestments of trust property. During the grantor's life, his wife and brother had power to change the beneficiaries and to amend the indentures in any respect. Is the grantor accountable under Sections 166, 167, or 22 (a) of the Revenue Act of 1934 for the income of these trusts?

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and regulations are set forth in the Appendix, *infra*, pp. 34–49.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 27–30) may be summarized as follows:

Taxpayer and his wife, Ellen Shumway Stuart, have three children: Joan, born May 31, 1904; Ellen, born June 21, 1907; and John, born January 1, 1912 (R. 27).

On March 31, 1930, taxpayer created three separate trusts, one for the benefit of each of his three children, and named himself, his wife, and his

brother, Robert Douglas Stuart, as the trustees of each trust. To the trustees of each trust taxpayer transferred 700 shares of the common stock of the Quaker Oats Company, of which he was president (R. 27).

The provisions of each of the three trust indentures were substantially the same. For a period of fifteen years the trustees were to pay over to the child designated as the beneficiary of the particular trust so much of the net income from the trust fund as they in their sole discretion should deem advisable and add the balance to corpus. After fifteen years the trustees were to pay the entire net income from the trust to the beneficiary for life (R. 27–28).

Upon the death of the beneficiary, the trustees were to pay over the principal of the trust to the beneficiary's issue then surviving or, if the beneficiary left no issue then surviving, to the issue then surviving of the taxpayer; or, if there were surviving no issue of the beneficiary or of taxpayer, to Princeton University and the University of Chicago in equal shares (R. 28).

The trustees were empowered to collect all income; to sell any of the securities held in trust; to invest the proceeds from the sale of securities and the net income added to trust principal in income-producing property or securities, real or personal, without being restricted to investments fixed by the statutes of Illinois; to execute all

necessary assignments and other instruments; to exercise the voting power upon all shares of stock held in trust; to exercise every power, and do every act and thing in respect of any shares of stocks and bonds which they could or might do if they were absolute owners thereof; to unite with others in carrying out any plan for the reorganization of any corporation, the securities of which were held in trust; to exchange the securities of any corporation for other corporate securities; to assent to the consolidation or merger of any corporation; to pay assessments and expenses for the protection of the interest of the trust in the securities of any corporation; and to employ agents and attorneys (R. 28).

Stock dividends, liquidating dividends and proceeds from the sale of any part of the trust funds, including profits, were to constitute principal (R. 28).

Each trust indenture contained a clause providing that the trustees were not to incur any liability except such as might be due to actual fraud or willful mismanagement, and a clause providing that any person dealing with the trustees was not to be required to see to the application of any money paid to the trustees (R. 28–29).

Paragraphs Eighth and Ninth of each trust indenture provided as follows (R. 29):

> Eighth. The Donor reserves and shall have the right at any time and from time

to time to direct the Trustees to sell the whole of the Trust Fund, or any part thereof, and to reinvest the proceeds in such other property as the Donor shall direct. The Donor further reserves and shall have the right at any time and from time to time to withdraw and take over to himself the whole or any part of the Trust Fund upon first transferring and delivering to the Trustees other property satisfactory to them of a market value at least equal to that of the property so withdrawn.

Ninth. During the life of the Donor, the said Ellen Shumway Stuart and the said Robert Douglas Stuart, or the survivor of them, shall have full power and authority, by an instrument in writing signed and delivered by them or by the survivor of them to the Trustees, *to alter, change or amend this Indenture at any time and from time to time by changing the beneficiary hereunder,* or by changing the time when the Trust Fund, or any part thereof, or the income, is to be distributed, or by changing the Trustees, *or in any other respect.* [Italics supplied.]

On August 3, 1935, taxpayer's wife and brother executed an amendment to each of the three trust indentures, canceling paragraph Eighth and changing paragraph Ninth to read as follows (R. 29):

Ninth. This Indenture and all of the provisions thereof are irrevocable and not subject to alteration, change or amendment.

The net income of each of the three trusts in 1934 and 1935 was as follows (R. 29):

Trust for—	1934	1935
Joan	$7,496.74	$8,295.00
Ellen	7,496.74	8,295.00
John	7,566.54	9,135.00
Total	22,560.02	25,725.00

Of the $25,725 income of the three trusts for 1935, $16,800 was received during the period from January 1, 1935, to August 3, 1935 (R. 30).

In 1934 and 1935 the following amounts of the net income of the three trusts were distributed to the beneficiaries (R. 30):

Trust for—	1934	1935
Joan	$7,496.74	$7,675.36
Ellen	7,496.74	7,473.80
John	1,393.35	2,740.50

In 1934 and 1935 Joan and Ellen were married (R. 30).

Taxpayer's net income (not including any income of the three trusts) was $167,257.45 in 1934 and $185,334.77 in 1935. At the time of the creation of the three trusts, taxpayer's net worth was in excess of $4,000,000, and the property which he transferred to the trusts had a value of approximately $575,000 (R. 30).

In determining the deficiencies for 1934 and 1935, the Commissioner included in the taxpayer's income the net income of each of the trusts for

1934 and the period from January 1 to August 3, 1935. The Board of Tax Appeals sustained the Commissioner's action but the court below reversed the decision of the Board.

This is a companion case to *Helvering* v. *R. Douglas Stuart*, No. 49, present Term, which has been placed on the summary docket for argument immediately following the instant one. In that case, as more fully shown by the record therein, to which reference is here made, the taxpayer created four trusts, one for the support and benefit of each of his four minor children, naming himself, his wife and his brother (the grantor in the instant case) as trustees. The corpus of each trust consisted of shares of stock in the Quaker Oats Company of which both brothers were officers. The trusts contained substantially the same provisions as the instant ones and also empowered the grantor's wife and brother to make any changes in those provisions. On August 2, 1935, the wife and brother relinquished that power. The *R. Douglas Stuart* case involves the same questions as the instant one and also an additional question, based upon the minority of his children, which is not presented here.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that the trust income was not taxable to the grantor under Sections 166, 167 or 22 (a) of the Revenue Act of 1934.

(2) In reversing the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

I

Section 166 of the Revenue Act of 1934 (Appendix, *infra*) provides that where at any time the power to revest in the grantor title to the corpus of a trust is vested in the grantor or in any person not having a substantial adverse interest, then the income of the trust is taxable to the grantor. In the instant case the grantor established three trusts, one for each of his children. During the grantor's lifetime, his wife and brother had power to change the beneficiaries and to amend the indentures in any respect. In the circumstances the statute is applicable, for the wife and brother could have revested in the grantor title to the trust properties and their interests were in harmony with and not adverse to those of the grantor in any real sense. The Board of Tax Appeals so held and its decision, which was reversed by the court below, should now be reinstated. Our position is supported by the Treasury Regulations, the legislative history and the applicable decisions of the courts.

II

Section 167 of the Revenue Act of 1934 (Appendix, *infra*) provides that where the income of

a trust is, or in the discretion of the grantor or of any person not having a substantial adverse interest may be, held or accumulated for future distribution to the grantor or, may, in the discretion of the grantor or of any person not having a substantial adverse interest, be distributed to the grantor; then the trust income shall be taxed to the grantor. In the instant case, under the broad power conferred upon the grantor's wife and brother, they could have changed the indentures so as to provide that the trust income be held or accumulated for future distribution to the grantor or that it be distributed to him currently. Hence the statute applies, for the wife and brother did not have interests which were substantially adverse to those of the grantor. Our views are supported by the regulations, the legislative history, and the pertinent court decisions.

III

As a further alternative, we submit that the grantor is taxable under section 22 (a) of the Revenue Act of 1934 (Appendix, *infra*) because he retained so many of the attributes of ownership in the trust properties as to justify treating him as owner under the theory of *Helvering* v. *Clifford*, 309 U. S. 331.

ARGUMENT

I

THE TRUST INCOME IS TAXABLE TO THE GRANTOR UNDER SECTION 166 OF THE REVENUE ACT OF 1934

Introductory.—The operation of section 166 (2) of the Revenue Act of 1934 (Appendix, *infra*) is not dependent on the grantor's having power himself to retake the corpus of the trust. This section taxes the grantor on the income of a trust wherever any person without a substantial adverse interest has power to revest title to the corpus of the trust in the grantor. In the instant case the grantor's wife and brother possessed the power to change the beneficiaries and to change completely the provisions of the trusts, including the power to restore the corpus to the grantor. Neither the wife nor the brother were beneficiaries in the trusts, and if neither of them had a substantial adverse interest, as we shall undertake to demonstrate, the grantor was taxable on the trust income under section 166 (2).

The legislative history of section 166 shows that the instant situation is the very type which was intended to be included within the statute. The first specific provision taxing grantors of revocable trusts upon the income therefrom[1]

[1] This provision was section 219 (g) of the Revenue Act of 1924, c. 234, 43 Stat. 253, which provided as follows: "SEC. 219. * * * (g) Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction

might not have reached this type of case, because it may have been applicable only where the power of revocation was in the grantor, either alone or in conjunction with someone not a beneficiary. In 1932 this provision was amended by section 166 of the Revenue Act of that year.[2] The purpose behind the changes in the provision is disclosed by the report of the Senate Committee on Finance (S. Rep. No. 665, 72d Cong., 1st Sess., p.

---

with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor." Subsequently the courts held that this provision was merely declaratory of existing law and that such grantors were also taxable under the general provisions of prior laws. *McCauley* v. *Commissioner*, 44 F. (2d) 919 (C. C. A. 5); *Dickey* v. *Burnet*, 56 F. (2d) 917 (C. C. A. 8), certiorari denied, 287 U. S. 606; *O'Donnell* v. *Commissioner*, 64 F. (2d) 634 (C. C. A. 9), certiorari denied, 290 U. S. 699. This provision was reenacted in the 1926 and 1928 Acts (Revenue Act of 1926, c. 27, 44 Stat. 9, sec. 219 (g); Revenue Act of 1928, c. 852, 45 Stat. 791, sec. 166) and was held constitutional in *Corliss* v. *Bowers*, 281 U. S. 376.

[2] Section 166 of the 1932 Act, c. 209, 47 Stat. 169, read as follows: "SEC. 166. *Revocable Trusts.* Where at any time during the taxable year the power to revest in the grantor title to any part of the corpus of the trust is vested — (1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or (2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor." Except for a change not here material the 1934 provision here involved is identical.

34 (1939–1 Cum. Bull. (Part 2), pp. 496, 520–521)), as follows:

SECTION 166. REVOCABLE TRUSTS.

Under the present law the income of a trust is taxable to the grantor where, at any time during the taxable year, the grantor has power to revest in himself title to any part of the corpus of the trust, either alone or in conjunction with any person not a beneficiary of the trust. *In an attempt to avoid this section, the practice has been adopted by some grantors of reserving power to revest title to the trust corpus in conjunction with a beneficiary having a very minor interest or of conferring the power to revest upon a person other than a beneficiary; in such cases the grantor has substantially the same control as if he alone had power to revoke the trust.* While it is, of course, yet to be established that such device accomplishes its purpose, it is considered expedient to make it clear that in any of these cases the income shall be taxed to the grantor. The House bill made the grantor of a trust taxable upon the income of any part of the corpus of the trust, where the power to revest in the grantor title to such part of the corpus was in the grantor alone or was in the grantor in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus. *Your committee has extended the scope of this provision so as to include, as well, the*

cases where the power to revest title to any part of the corpus is held, either alone or in conjunction with the grantor, by a person not having a substantial adverse interest in such part of the corpus or in the income therefrom. [Italics supplied.]

This report is of double significance. It not only states that the section was being amended to tax the grantor where the power to revest lay not in him but in another person without a substantial adverse interest, but it also tends to afford certainty to the meaning of the term "a substantial adverse interest." The report shows concern with a practice of a two-fold nature which had arisen: grantors were conferring the power of revocation either (1) on "a person other than a beneficiary" or (2) conjunctively with the grantor on "a beneficiary having a very minor interest," and thus were seeking to avoid the effect of a statute which did not tax them unless they reserved power in themselves to revoke "either alone or in conjunction with any person not a beneficiary." In consequence of this concern, the phrase "any person not having a substantial adverse interest" was placed in the statute, making the grantor taxable wherever such a person, either alone or with the grantor, could revest title to the corpus in the grantor. By use of the phrase "any person not having a substantial adverse interest" the committee thus intended to describe

(1) beneficiaries with minor interests and (2) all persons other than beneficiaries.

The court below, however, refused to give effect to the plain language of section 166 and the unambiguous purpose of Congress. As we read the court's opinion, it ruled: (1) That section 166 applies only where the grantor has reserved in his grant the right to recapture the corpus by his own act and the grantor here reserved no such right; (2) that in any event the fiduciary position of the grantor's wife and brother prevented them from restoring the corpus to the grantor; and (3) that, finally, the wife and brother had substantial adverse interests. We submit that the court erred in each respect.

1. Section 166 plainly provides that the grantor shall be taxed if the requisite power is either reserved by the grantor or is bestowed on any person not having a substantial adverse interest. The court below seemed to rest its conclusion that the grantor is taxable only where he himself has the power of revocation, on certain language in Article 166–1 (b) of Treasury Regulations 86, as originally promulgated (Appendix, *infra*). This regulation provided in part that the single test of taxability is whether the grantor has failed to divest himself, permanently and definitely, of every right which might by any possibility enable him once more to possess and enjoy in title the trust corpus. But the true significance of this

portion of the regulation is apparent when it is read in conjunction with the sentence immediately following it:

> For the purposes of this article the sufficiency of the grantor's retained interest in the corpus is not affected by the fact that the grantor has provided that the right to cause the title to the corpus to revest in himself is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the corpus or income therefrom adverse to the grantor.

This and other provisions of the regulations, both as originally adopted and as amended (Appendix, *infra*), abundantly evidence the lack of any adequate basis for the conclusion that those regulations have interpreted the statute to apply only where the power to revest is excercisable by the grantor himself. And we know of no other case where the statute and the regulations have been so construed. On the other hand, the courts have uniformly held that the grantor is taxable where the power to revest is exercisable only by another person not having a substantial adverse interest. *Morton* v. *Commissioner,* 109 F. (2d) 47 (C. C. A. 7); *Helvering* v. *Evans,* 126 F. (2d) 270 (C. C. A. 3), application for certiorari pending, Nos. 107–108, present Term; cf. *Commissioner* v. *Caspersen,* 119 F. (2d) 94 (C. C. A. 3), certiorari denied, 314 U. S. 643; *Loeb* v. *Commissioner,*

113 F. (2d) 664 (C. C. A. 2), certiorari denied, 311 U. S. 710. Indeed, the court below was apparently not content to dispose of section 166 solely upon its conclusion as to this point for it proceeded to consider the other questions raised by the parties.

2. The next question is whether the grantor's wife and brother had power to restore the trust properties to him. We submit that the provisions of Article Ninth of the agreement, above referred to, are broad enough to authorize such action. The Board of Tax Appeals so construed the agreement but the court below took the view that under the law of Illinois the power was a fiduciary power, vested in the wife and brother as trustees, and subject to the control of a court of chancery which would not permit them to defeat the interests of the children-beneficiaries. We submit that such reasoning is fallacious because it virtually nullifies the existence of the power, since it is difficult to imagine how the express power to change beneficiaries could be exercised at all if it could not be exercised so as to defeat the interests of the original beneficiaries. Such reasoning is fallacious for the added reason that it overlooks the essential character of the power, which was a general power given to the wife and brother as individuals, not as trustees. The exercise of the power was not subject to fiduciary obligations. It is immaterial that the wife and brother were also named as trustees.

Reinecke v. *Smith*, 289 U. S. 172, 176–177, is dispositive of this issue. See also *Chandler* v. *Commissioner*, 119 F. (2d) 623 (C. C. A. 3).

Even if the question be examined *de novo*, however, it seems clear that under the law of Illinois, the wife and brother could have transferred the corpus back to the grantor without interference by a court of equity. *The People* v. *Kaiser*, 306 Ill. 313, 316–317; *Rock Island Bank* v. *Rhoads*, 353 Ill. 131, 141; *Botzum* v. *Havana National Bank*, 367 Ill. 539, 543; *Pomeroy's Equity Jurisprudence* (5th ed.), Vol. 3, sec. 1002. There is no suggestion in the instant case that the donees of the power were indebted so that they might have been required to exercise it in favor of their creditors in preference to any other person. *Gilman* v. *Bell*, 99 Ill. 144, 151; *Northern Trust Co.* v. *Porter*, 368 Ill. 256, 266–267. Cases such as *Maguire* v. *City of Macomb*, 293 Ill. 441; *Welch* v. *Caldwell*, 226 Ill. 488; *Jones* v. *Jones*, 124 Ill. 254; and *Frank* v. *Frank*, 305 Ill. 181, cited by the court below (R. 44–45) are not at variance with our position here. None of those cases was concerned with a power so broad and sweeping as the one in the instant case and none of them holds or even intimates that such a power would not be exercisable in accordance with its terms.

3. The question remains whether the wife and brother had interests which were substantially

adverse to a restoration of the trust properties to the grantor. The court below stated (R. 43) that if the wife and brother had the power to name themselves, or others than the grantor, as beneficiaries, that power was certainly adverse to the grantor's interests. This argument would prove too much, for it means, if sound, that any donee of a general power has a substantial adverse interest within the meaning of the statute. But a donee of a power is not a beneficiary,[3] and, as the legislative history shows, Congress was thinking of beneficiaries with more than a minor interest when it used the phrase "a substantial adverse interest." If the theory of the court below be correct, then any grantor could avoid the effect of section 166 by including the power to revest within a power of appointment and thereby defeat the known purpose of Congress.

However, even if the mere donee of a general power could be regarded as having an "adverse interest" within the intendment of Congress, the grantor herein would be taxable since the donees' interest, even if adverse, is not substantial. In the instant case, the power could be exercised only during the lifetime of the grantor while his

[3] A general power of appointment does not of itself vest any estate in the donee (*United States* v. *Field*, 255 U. S. 257; *Helvering* v. *Safe Deposit & Trust Co. of Baltimore*, 316 U. S. 56; *Gilman* v. *Bell*, *supra*; *Botzum* v. *Havana National Bank*, *supra*).

influence could make itself felt, and then only by his wife and brother. There is not any evidence in the record to justify treating either the wife or brother as a complete stranger, or to justify a disregard of "the normal consequences of family solidarity." See *Helvering* v. *Clifford*, 309 U. S. 331, 337.

One would not assume that a wife would, in defiance of her husband's wishes, exercise for her own benefit a power given her by her husband, yet the court below made that very assumption, based on no evidence and contrary to the Board's finding. The decision below is thus inconsistent with the reasoning in the *Clifford* case, and is contrary to decisions of other circuit courts of appeal, such as *Commissioner* v. *Caspersen*, 119 F. (2d) 94 (C. C. A. 3), certiorari denied, 314 U. S. 643; *Altmaier* v. *Commissioner*, 116 F. (2d) 162 (C. C. A. 6), certiorari denied, 312 U. S. 706; *Loeb* v. *Commissioner*, 113 F. (2d) 664 (C. C. A. 2), certiorari denied, 311 U. S. 710; *Fulham* v. *Commissioner*, 110 F. (2d) 916 (C. C. A. 1); and *Rollins* v. *Helvering*, 92 F. (2d) 390 (C. C. A. 8), certiorari denied, 302 U. S. 763, all of which fully support our position that a wife in a normal household who has been given rights in a trust by her husband cannot be regarded as having "a substantial adverse interest" to her husband in the realistic sense in which Congress intended that term to be understood, at least where the wife

does not have a present, existing beneficial interest.

Similarly, the grantor's brother cannot be treated as having a substantial adverse interest within the meaning of the statute. In addition to their close ties of blood, they were business associates. The grantor was president and his brother was vice president of a large corporation, stock in which constituted the assets of the trusts (R. 27; see also p. 27 in Record in companion case, *Helvering* v. *R. Douglas Stuart*, No. 49). Thus in addition to the normal brotherly regard and trust existing between them there was the friendship and confidence built on successful business association. In any event, the hard-headed necessity of maintaining a common front for the purpose of retaining the control over the corporation which their positions evidenced would probably deter the brother from disrupting the existing harmonious relationship with the grantor by naming himself beneficiary, or by naming the grantor's wife beneficiary, against the grantor's wishes.

Moreover, the grantor in this case possessed the same powers under the trusts established by his brother (see p. 29, Record in No. 49) as the brother possessed under the trusts herein. If the brother should exercise his powers herein in defiance of the grantor's wishes, the grantor would be in a position himself to do the identical thing under the trusts involved in No. 49. In these cir-

cumstances the brother would be quite unlikely to exercise his powers herein in any manner not desired by the grantor, so any adverse interest possessed by the brother is at most insubstantial. (Compare *Commissioner* v. *Warner*, 127 F. (2d) 913 (C. C. A. 9).)

Finally, the total lack of substance in any adverse interest of the wife and brother is shown by the fact that, for either to become beneficiary of these trusts in defiance of the grantor's wishes, the consent of the other would be necessary. Thus, before the brother could become beneficiary he would have to persuade the grantor's wife to join with him in the exercise of the power. And similarly the wife would have to persuade her husband's brother to assist her before she could become beneficiary. It is evident that the grantor carefully placed the power so that the chances of its being used in defiance of his wishes were too remote to be considered.

The court below seemed to suggest (R. 42) that the wife might be unwilling to exercise the power in favor of her husband because to do so would be to impoverish her children. Such considerations are not pertinent to the issue herein. Conceivably Mrs. Stuart's love for her children might make her reluctant to accede to her husband's wishes to convey the trust property back to him, but it is equally true that a corporate trustee might view with disfavor because of the loss of

fees a request of a grantor that trust assets be reconveyed to him and the trust terminated. Yet the interest of a corporate trustee is not a substantial adverse interest (Reg. 86, Art. 166–1 (b); Reg. 94, Art. 166–1 (b); Reg. 103, Sec. 19.166–1 (b); *Morton* v. *Commissioner,* 109 F. (2d) 47 (C. C. A. 7); compare *Reinecke* v. *Smith,* 289 U. S. 172). However compelling the motive may be for not revesting title to the corpus in the grantor, the grantor is taxable under the Congressional enactment unless that motive be in the form of "a substantial adverse interest in the * * * corpus."

For the foregoing reasons we submit that the finding of the Board that the wife and brother did not have a substantial adverse interest was correct and consequently the court below improperly reversed the Board. This case is a typical one where the grantor retained the controlling hand over something he had seemed to give away and consequently section 166 is applicable here with the effect of taxing the grantor on the income of the trusts.

II

SECTION 167 ALSO APPLIES

Section 167 of the Revenue Act of 1934 (Appendix, *infra*) is like section 166 except that it emphasizes the power to pay the income of the trust to the grantor instead of the power to re-

vest the corpus in the grantor. Thus, if the power resides in anyone not possessing a substantial adverse interest in the income to pay the income to the grantor or to accumulate it for future payment to him, the grantor is taxable on the income of the trusts.

Under this section the grantor is taxable on the income of the trusts herein involved, because his wife and brother could have caused the income of the trusts to be paid to him or to be accumulated for future distribution to him. The discussion under the previous heading of this brief of the broad character of the donees' power and of their lack of a substantial adverse interest is equally pertinent here and demonstrates that the conditions necessary for the application of section 167 are present.

Sections 166 and 167 often overlap. They are designed to prevent tax avoidance, and the fact that they often overlap tends to prevent a tax avoidance scheme from slipping through a hole between them. The predecessor of section 167 was section 219 (h) of the Revenue Act of 1924, reenacted as section 219 (h) of the 1926 act and as section 167 of the 1928 act. It had much the same defects as its companion provision, section 166, and consequently was amended in 1932 together with section 166. With its 1932 amendments it was reenacted in 1934.

The purpose of the 1932 amendment is outlined in S. Rep. No. 665, 72d Cong., 1st Sess., pp. 34–35 (1939–1 Cum. Bull. (Part 2), pp. 496, 521) as follows:

> SECTION 167. INCOME FOR BENEFIT OF GRANTOR.
>
> As in the case of the preceding section, attempted avoidance of the provisions of this section, relating to income held or accumulated for the grantor, has rendered expedient a change in its wording to check certain recent practices. The present law taxes the income of a trust to the grantor when in his discretion, either alone or in conjunction with a person not a beneficiary, the trust income may be held or accumulated for future distribution to him, or is or may be applied to the payment of premiums upon insurance policies on the grantor's life. Trusts have been established in which income is held or accumulated for the grantor, which fact, it is contended, removes such trusts from the operation of this section. Here again, it is not at all certain that the courts will uphold such devices; yet the statute may well be clarified to remove any doubt that the income of such trusts is to be taxed to the grantors. In the House bill, the section has been amended to provide that there shall be taxed to the grantor of a trust any part of the income of the trust which (1) is, or in the grantor's discre-

> tion may be, held or accumulated for future distribution to him, or (2) may, in the grantor's discretion, be distributed to him, or (3) is, or in the grantor's discretion may be, applied to the payment of premiums upon policies of insurance on his life. *Your committee has further amended the section so as to cover, in addition, cases in which the discretion as to the disposition of the income is in any person not having a substantial adverse interest in the disposition of such income, even though such discretionary power is not shared with the grantor.* The House bill added a subsection defining the term "in the discretion of the grantor," so as to include within the purview of the section cases in which the discretion is in the grantor in conjunction with any person not having a substantial adverse interest in the disposition of the income in question. [Italics ours.]

We submit that the instant case falls within the scope of the amendment for the grantor here bestowed on his wife and brother powers which would have permitted them to alter the trusts so as to pay the income to the grantor or accumulate it for distribution to him. As we have seen, the wife and brother did not possess a substantial adverse interest.

Article 167–1 of the regulations, both as originally adopted and as amended (Appendix, *infra*), provides that the test of taxability to the grantor is whether he has failed to divest himself, both

permanently and definitively, of every right which might, by any possibility, enable him to have such income, at some time, distributed to him, either actually or constructively. We submit that under the regulations, the grantor here is taxable upon the trust income in question, for he gave to his wife and brother the power to distribute it to him, either presently or in the future. We further submit that the regulations, as applied to the instant case, are appropriate and reasonable. *Magruder* v. *Washington, Baltimore & Annapolis Realty Corp.*, 316 U. S. 69; *Fawcus Machine Co.* v. *United States*, 282 U. S. 375; see *Manhattan Co.* v. *Commissioner*, 297 U. S. 129, 134. Furthermore, the fact that these regulations have remained without substantial modification through the subsequent reenactments of the law (Treasury Regulations 94, Art. 167–1, promulgated under the Revenue Act of 1936, Sec. 167; Treasury Regulations 101, Art. 167–1, promulgated under the Revenue Act of 1938, Sec. 167; Treasury Regulations 103, Sec. 19.167–1, promulgated under the Internal Revenue Code, Sec. 167) affords additional basis for their validity. *Taft* v. *Commissioner*, 304 U. S. 351; *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459; *Morrissey* v. *Commissioner*, 296 U. S. 344, 355.

Since section 167 was enacted to prevent tax avoidance through the trust device, it should be construed so that it may effectuate its intended

purpose. As the court said in *Kaplan* v. *Commissioner*, 66 F. (2d) 401, 402 (C. C. A. 1), with reference to the section of an earlier act corresponding to section 167 of the Revenue Act of 1934:

> We see no occasion for refinement of construction against the government. We think the statute means that if under any circumstances or contingencies any part of the accumulated income might inure to the benefit of the grantor such portion of the income is taxable to him.

Under that interpretation of the law, the grantor in the instant case would be accountable for the trust income here involved. The *Kaplan* case has been cited with approval in later cases such as *Helvering* v. *Evans*, *supra*, and *Altmaier* v. *Commissioner*, *supra*.

And in *Kent* v. *Rothensies*, 120 F. (2d) 476 (C. C. A. 3), certiorari denied, 314 U. S. 659, the court said (p. 478):

> * * * when we consider that Congress was dealing with the problem of eliminating the use of the trust device as a means of avoiding surtaxes we can hardly think that it intended to weaken the effectiveness of the remedy it was devising by making it applicable only when the right of a grantor to accumulations of trust income was vested or unconditional. * * *

See also *Commissioner* v. *Caspersen*, *supra*; *Loeb* v. *Commissioner*, *supra*; *Rollins* v. *Helver-*

ing, supra; White v. *Higgins,* 116 F. (2d) 312, 318 (C. C. A. 1); *Irish* v. *Commissioner,* 129 F. (2d) 468 (C. C. A. 3); *Phipps* v. *Helvering,* 124 F. (2d) 288 (App. D. C.).

In the circumstances we submit that the income of the trust is taxable to the grantor under section 167.

III

AS A FURTHER ALTERNATIVE, THE INCOME OF THE TRUSTS IS TAXABLE TO THE GRANTOR UNDER SECTION 22 (A) OF THE REVENUE ACT OF 1934

In the court below we also contended that this case is controlled by *Helvering* v. *Clifford,* 309 U. S. 331, but our contention was overruled. We submit that this was error and that the taxpayer remained in substance the owner of the trusteed properties and taxable upon the income therefrom under the rule of the *Clifford* case.

In that case, the grantor was held taxable under section 22 (a) of the Revenue Act of 1934, upon trust income paid to his wife, as beneficiary, where the trust was to continue for a short term of five years or until prior death of the taxpayer or his wife, and upon termination of the trust the corpus was to go to the grantor or his estate but any undistributed net income was to be treated as the property of the wife. The grantor was the sole trustee with broad powers of control over the trust property. The

reason for the decision was that the grantor retained so many of the attributes of ownership as to justify the conclusion that he continued to be the owner of the trust properties within the meaning of section 22 (a).

The rule in the *Clifford* case has not been restricted to the precise facts there presented and it has been applied in many other cases presenting a variety of factual backgrounds. Some of these cases are as follows: *Hormel* v. *Helvering*, 312 U. S. 552; *Helvering* v. *Horst*, 311 U. S. 112; *Harrison* v. *Schaffner*, 312 U. S. 579; *Commissioner* v. *Buck*, 120 F. (2d) 775 (C. C. A. 2); *Commissioner* v. *Brown*, 122 F. (2d) 800 (C. C. A. 3); *Jacobs* v. *Commissioner*, 129 F. (2d) 99 (C. C. A. 5); *Cox* v. *Commissioner*, 110 F. (2d) 934 (C. C. A. 10), certiorari denied, 311 U. S. 667; *Whiteley* v. *Commissioner*, 120 F. (2d) 782 (C. C. A. 3), certiorari denied, 314 U. S. 657; *Commissioner* v. *Berolzheimer*, 116 F. (2d) 628 (C. C. A. 2); *White* v. *Higgins*, *supra*; *Helvering* v. *Elias*, 122 F. (2d) 171 (C. C. A. 2), certiorari denied, 314 U. S. 692; *McKnight* v. *Commissioner*, 123 F. (2d) 240 (C. C. A. 8).

Indeed, in *Helvering* v. *Fuller*, 310 U. S. 69, 76, this Court indicated that where the grantor retained substantial control over the trust property he might be taxable under the rule in the *Clifford* case even though the trust was for a

term of ten years at the expiration of which the corpus was to be transferred to his divorced wife.

In *Commissioner* v. *Buck, supra,* the Second Circuit held the grantor accountable for the income of a family trust where he reserved power to manage the corpus and also the right to change the provisions as to disposition of income or principal, provided, however, that he could not direct payment to himself. In so holding, the Court expressed the view that where the grantor retains sufficient control over the trust properties he may be taxed under the rule of the *Clifford* case even though the trust is not for a short term only.

In *Commissioner* v. *Brown, supra,* the facts are similar to those in the *Buck* case and the court remanded the case to the Board for further consideration in the light of the *Clifford* case as the taxpayer had not had an opportunity to adduce evidence on this point at the Board hearing.

In *Jacobs* v. *Commissioner, supra,* the Fifth Circuit upheld the Board's conclusion that the grantor was taxable under the *Clifford* rule where by the joint action of taxpayer and his wife, the trust funds might be devoted to any use to which a private owner of the assets might put them, or the trust could immediately be terminated and the property conveyed to the settlor. The court said (p. 100):

> Where such complete dominion over a trust is vested in the settlor and his wife,

to hold that the power of joint control in the wife relieves the settlor of the burdens of the tax upon the income produced would be "to let mere formalism obscure the normal consequences of family solidarity, and to force concepts of ownership to be fashioned out of legal niceties which may have little or no significance."

In the instant case the record supports the conclusion that the taxpayer's control over the trusteed properties was not substantially reduced by the transfers in trust. These properties were shares of stock in a corporation of which taxpayer was president and his brother was first vice president. The trustees named in each indenture were taxpayer, his wife, and brother. They were given broad control over the properties, including the power to sell and to vote or otherwise act with respect thereto, and if taxpayer was not satisfied with the control exercised by his cotrustees over the voting power, he was empowered by article Eighth of the trust instrument to buy back the stock. He could direct reinvestments. For a period of fifteen years the trustees were to pay over to each child of the grantor so much of the income of his trust as they should deem advisable and add the balance to corpus. After the expiration of the fifteen year period, the children were to get the entire income. Upon death of the beneficiary, the corpus was to go to his issue. The grantor's wife

and brother were given power to change the beneficiaries and to amend the indentures in any respect. (See trust indenture, R. 15–19.)

In the circumstances, we submit that here, as in the *Clifford* case, the grantor retained enough of the attributes of ownership of the trust funds to justify taxing the income to him under Section 22 (a). The situation presented by the instant case is that of a wealthy man who had been giving allowances to his children and who by creating the trusts gave formality to his wish to provide an income for them, reserving complete control over the disposition of corpus and income either directly or through the instrumentality of his wife and brother, who, as we have seen, had no interest which would be adverse to carrying out the purposes of the grantor. Indeed, the brother executed similar trusts in favor of his own children and conferred upon his wife and brother (this grantor) the power to change them in any respect. This heightens the probability that each brother would have exercised the power only in accordance with the wishes of the other; and the record fully supports the conclusion of the Board of Tax Appeals that the interests of both the wife and the brother were in harmony with and not antagonistic to those of the grantor.

We submit that the instant case falls within the scope of the *Clifford* case and other decisions following it, cited above. Moreover, the result

would not be altered even if it should be thought, contrary to our views expressed herein, that no changes could be made in the trusts which would divert the corpus or income to the grantor within the meaning of sections 166 or 167. *Commissioner* v. *Buck, supra; Commissioner* v. *Brown, supra;* see *Helvering* v. *Fuller, supra;* cf. *Estate of Sanford* v. *Commissioner,* 308 U. S. 39.

CONCLUSION

The judgment of the court below should be reversed.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
L. W. POST,
Special Assistants to the Attorney General.
VALENTINE BROOKES,
Attorney.

OCTOBER 1942.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * * *

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor.

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question."

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 22. (a)-1. *What included in gross income.*—Gross income includes in general

compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

* * * * * * *

ART. 166–1 [as originally promulgated]. *Trusts in the corpus of which the grantor retains an interest*—(*a*) *Scope.*—Section 166 prescribes that the income, or any part of the income, of certain trusts shall be taxed, not to the trustee nor to the beneficiaries, but to the grantor because of the fact that the grantor has retained a certain interest in the property of the trust. This article deals with the taxation of such income. The term "corpus," as used in this article, means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(*b*) *Test of taxability to the grantor.*—The sufficiency of the grantor's retained interest in the corpus resulting in the taxation of its income to the grantor is determined by a single test, namely, whether the grantor has failed to divest himself, permanently and definitively, of every right which might by any possibility enable him once more to possess and enjoy in title the trust corpus. For the purposes of this article the sufficiency of the grantor's retained interest in the corpus is not affected by the fact that the grantor has provided that the

right to cause the title to the corpus to revest in himself is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the corpus or income therefrom adverse to the grantor.

If the grantor has retained any such interest in the corpus he is taxable on the income therefrom regardless of—

(1) how great or how small, how remote or how contingent the interest may be;

(2) whatever the nature of interest retained may be; whether the interest retained is vested, contingent, in reversion, or otherwise; whether conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event; whether taken by appointment, or by designation in the trust instrument, or merely by virtue of the grantor not conveying his whole estate in the corpus, or otherwise;

(3) the time or times at which such interest will revest the title in the grantor in possession and enjoyment, whether within or without the taxable year, whether or not the time be fixed, determinable or certain to come;

(4) whether, if the revesting in the grantor of title to the corpus is in any way dependent upon the act of anyone, that person be the grantor, or any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(5) when the trust was created.

For example, a grantor has not permanently or definitively divested himself of

title to the corpus if he has placed it in trust for his son, John,

(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such an extension the title is once more to revest in the grantor in possession and enjoyment; or

(B) for the term of a year and a day, then to be distributed to whomsoever the wife of the grantor shall by deed appoint (the wife not being a beneficiary, but being empowered to appoint to anyone other than herself); or,

(C) for the term of the grantor's life, then to be distributed to John, the grantor reserving, however, the right to alter, amend, or revoke any provision of the trust instrument, upon notice of a year and a day.

In these typical cases the grantor has provided that the title shall or may once more revest in himself by the retention of an interest (executory or otherwise) capable of vesting title in the grantor in possession and enjoyment, in (A) upon the expiration of the trust period if the grantor does not exercise his option to extend the trust, in (B) upon the designation of the grantor as distributee, by a person not substantially and adversely interested, and in (C) upon the revocation of the trust instrument or an alteration or amendment thereof, resulting in the designation of the grantor as distributee.

Thus the inclusion within the scope of section 166 of any trust is based on the fact that the grantor has retained an interest in the corpus which once more will, or may

possibly, vest the title in him in possession and enjoyment. Section 166 makes no distinction between a "revocable trust" (so called because of a provision in the trust instrument permitting some person at some time or in some manner to terminate the trust) and an "irrevocable trust" as such. Some "revocable trusts" are within the scope of section 166, not however by reason of the element of revocability, but because the grantor has reserved the requisite interest in the trust corpus, whether the vesting in title of such interest depends on revocation or otherwise. If no such interest has been retained, a "revocable trust" is not within the scope of section 166, even though the particular trust estate is subject to revocation by the grantor.

If the grantor strips himself permanently and definitively of every such interest in the corpus retained by him, the income of the trust realized after the effective date of such divesting is not taxable to the grantor but is taxable as provided in sections 161 and 162.

(*c*) *Income and deductions.*—If, as to any of the corpus, the test of taxability to the grantor is satisfied, the gross income of such corpus shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to such corpus as he would have been entitled to had the trust not been created.

ART. 166–1 [as amended by T. D. 4629, XV–1 Cum. Bull. 140, 141 (1936), and T. D. 4759, 1937–2 Cum. Bull. 117, 118]. *Trusts, with respect to the corpus of which, the grantor is regarded as remaining in substance the owner.*—(*a*) If the grantor of a trust is regarded, within the meaning

of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163 but remains attributable and taxable to the grantor. This article deals with the taxation of such income. As used in this article, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(*b*) Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. For the purposes of this article the grantor is deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to revest in the grantor. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor regardless of—

(1) whether such power or ability to retake the trust corpus to the grantor's own use is effected by means of a power to revoke, to terminate, to alter or amend or to appoint;

(2) whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) the time at which the title to the corpus will revest in the grantor in possession and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come;

(4) whether the power to revest in the grantor title to the corpus is in the grantor, or in any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or in both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(5) when the trust was created.

But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

In determining whether the grantor is in substance the owner of the corpus, the Act has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used, nor on the technical description which the law of property gives to the estate or interest transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: the fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor or those which he would ordinarily and naturally make; and any other circumstances bearing on the impermanence and indefi-

niteness with which the grantor has parted with the substantial incidents of ownership in the corpus.

Thus the grantor is regarded as being in substance the owner of the corpus if, in any case, the trust amounts to no more than an arrangement whereby the grantor, in the ordering of his affairs, finds it expedient to entrust for a period the title to, and custody or management of, certain of his property to a trustee, the income from such property to be used by the trustee during such period to make those expenditures which the grantor would customarily or ordinarily or naturally make and to which the grantor chooses to commit himself in advance, while the corpus is to be held intact, for return in due course to the grantor. In such a case, it is immaterial that, at the time of the creation of the trust, an irrevocable disposition or consummated gift was made of those property rights which consist of the right to the expected future income of the corpus for the specified period. On the other hand, if the grantor, incident to a definitive and permanent disposition of certain of his property, creates the trust in order to conserve the property, not for himself but for the donees, who will ultimately enjoy it, the provisions of sections 161, 162, and 163 are applicable.

(*c*) For example, a grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John.

(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such an extension the title is

once more to revest in the grantor in possession and enjoyment; or

(B) for the term of a year and a day, then to be distributed to whomsoever the wife of the grantor shall by deed appoint (the wife not having a substantial adverse interest in the disposition of the corpus or the income therefrom); or

(C) for the term of the grantor's life, then to be distributed to John, the grantor reserving, however, the right to alter, amend, or revoke any provision of the trust instrument, upon notice of a year and a day.

In these typical cases the grantor is regarded as having retained the substantial incidents of ownership with respect to the income-producing property since the corpus will or may once more revest in himself in (A) upon the expiration of the trust period if the grantor does not exercise his option to extend the trust, in (B) upon the designation of the grantor as distributee, by a person not substantially and adversely interested, and in (C) upon the revocation of the trust instrument or an alteration or amendment thereof, resulting in the designation of the grantor as distributee.

(*d*) If the grantor is regarded as remaining in substance the owner of the corpus the gross income of such corpus shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to the corpus as he would have been entitled to had the trust not been created.

If the grantor strips himself of the substantial incidents or attributes of ownership in the corpus retained by him so that he ceases to be regarded as in substance the

owner of the corpus, the income thereof realized after the effective date of such divesting is not taxable to the grantor but is taxable as provided in sections 161, 162, and 163.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the corpus or the income therefrom. If the power to revest title in the grantor is vested in him in conjunction with such person, or is vested solely in such person, there is to be excluded in computing the net income of the grantor only the income of such part.

ART. 167-1 [as originally promulgated]. *Trusts in the income of which the grantor retains an interest.*—(*a*) *Scope.*—Section 167 prescribes that the income, or any part of the income, of certain trusts shall be taxed to the grantor, not because the grantor has retained a certain interest in the *corpus* of the trust (as in section 166), but because of his retention of a certain interest in the *income* of the trust. This article deals with the taxation of such income. The term "income," as used in this article, means any part or the whole of the income of the trust.

(*b*) *Test of taxability to the grantor.*—The test of the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether the grantor has failed to divest himself, permanently and definitively, of every right which might, by any possibility, enable him to have the income, at some time, distributed to him, actually or constructively. Such a distribution to the grantor occurs if the income is paid to him or to another according to the grantor's direction or if, though paid to another pursu-

ant to the terms of the trust, the benefit of the income inures to the grantor. The income so inures if it is or may be applied in satisfaction of a legal obligation of the grantor, does or may increase his net worth, does or may in any way enrich him, or does or may enable him in any way to enjoy, in substance, such income. Such a distribution also occurs if the income is applied in payment of premiums upon policies of insurance on the grantor's life.

For the purposes of this article, the sufficiency of the grantor's retained interest in the income is not affected by the fact that the grantor has provided that the right to so effect or direct the distribution of income is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the income adverse to the grantor.

If the grantor has retained any such interest in the income, such income is taxable to the grantor regardless of—

(1) whether it may be distributed currently or accumulated for future distribution;

(2) whether such distribution, either current or subject to accumulation, is fixed by the trust instrument or is dependent on an exercise of discretion;

(3) whether, if such distribution is in any way effected by or dependent on an exercise of discretion, the person exercising the discretion is the grantor or a person not having a substantial interest in the income adverse to the grantor, or both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(4) whether, if such distribution results in the inuring of benefits to the grantor from the application of the income in satisfaction of his legal obligation, such obligation is to pay a debt, to support dependents, to pay alimony, to furnish maintenance, and support or otherwise;

(5) the time or times of such distribution, whether within or without the taxable period, whether conditioned on the precedent giving of notice, or on the elapsing of an interval of time, or on the happening of a specified event, or otherwise;

(6) when the trust was created.

Thus the inclusion of any trust within the scope of section 167 is based on the fact that the grantor has retained an interest in the income therefrom by which he is, or may be enabled at some time, to receive its benefits. If the grantor strips himself permanently and definitively of every such interest retained by him, the income of the trust realized after such divesting takes effect is not taxable to the grantor, but is taxable as provided in sections 161 and 162.

(*c*) *Income and deductions.*—If, as to any of the income, the test of taxability to the grantor is satisfied, such income shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to such income as he would have been entitled had such income been distributable currently to him.

ART. 167–1 [as amended by T. D. 4759, *supra*, and T. D. 4860, 1938–2 *Cum. Bull.* 184]. *Trusts in the income of which the grantor retains an interest.*—(*a*) *Scope.*—Section 167 prescribes that the income, or any part of the income, of certain trusts shall be taxed to the grantor, not because

the grantor has retained a certain interest in the *corpus* of the trust (as in section 166) but because of his retention of a certain interest in the *income* of the trust. This article deals with the taxation of such income. The term "income," as used in this article, means any part or the whole of the income of the trust.

(*b*) *Test of taxability to the grantor.*—The test prescribed by the Act as to the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether he has failed to divest himself, both permanently and definitively, of every right which might, by any possibility, enable him to have such income, at some time, distributed to him, either actually or constructively. Such a distribution to the grantor occurs within the meaning of section 167 if the income is paid to him or to another in obedience to his direction or if the income is applied in payment of premiums upon policies of insurance on the grantor's life.

For the purposes of this article, the sufficiency of the grantor's retained interest in the income is not affected by the fact that the grantor has provided that the right to so effect or direct the distribution of income is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the income adverse to the grantor.

If the grantor has retained any such interest in the income, such income is taxable to the grantor regardless of—

(1) whether it may be distributed currently or accumulated for future distribution;

(2) whether such distribution, either current or subject to accumulation, is fixed by the trust instrument or is dependent on an exercise of discretion;

(3) whether, if such distribution is in any way effected by or dependent on an exercise of discretion, the person exercising the discretion is the grantor or a person not having a substantial interest in the income adverse to the grantor, or both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(4) the time or times of such distribution, whether within or without the taxable period, whether conditioned on the precedent giving of notice, or on the elapsing of an interval of time, or on the happening of a specified event, or otherwise;

(5) when the trust was created.

Thus the inclusion of any trust within the scope of section 167 is based on the fact that the grantor has retained an interest in the income therefrom by which he is, or may be enabled at some time, to receive its benefits. But the provisions of section 167 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act similarly regarded as remaining in substance the owner of the trust income. If, for example, trust income is applied in satisfaction of the grantor's legal obligation whether to pay a debt, to support dependents, to pay alimony, to furnish maintenance and support, or otherwise, such income is in all cases taxable to the grantor.

If the grantor strips himself permanently and definitively of every such interest retained by him, the income of the trust re-

alized after such divesting takes effect is not taxable to the grantor but is taxable as provided in sections 161 and 162.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the income. There is to be excluded in computing the net income of the grantor only that part of the trust income in the disposition of which such person has a substantial interest adverse to the grantor.

(*c*) *Income and deductions.*—If, as to any of the income, the test of taxability to the grantor is satisfied, such income shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to such income as he would have been entitled had such income been distributable currently to him.

U. S. GOVERNMENT PRINTING OFFICE: 1943